

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF EDMONSON COUNTY WATER)	
DISTRICT, EDMONSON COUNTY, KENTUCKY, FOR)	
A CERTIFICATE OF CONVENIENCE AND NECESSITY)	
AUTHORIZING SAID DISTRICT TO CONSTRUCT)	
ADDITIONS, EXTENSIONS AND IMPROVEMENTS TO)	
ITS EXISTING MUNICIPAL WATER DISTRIBUTION)	CASE NO.
SYSTEM PURSUANT TO THE EXPRESS PROVISIONS)	8950
OF CHAPTERS 74 AND 106 OF THE KENTUCKY)	
REVISED STATUTES; SEEKING APPROVAL OF A)	
NEW SCHEDULE OF WATER SERVICE RATES AND)	
CHARGES; AND SEEKING APPROVAL FOR THE)	
ISSUANCE OF CERTAIN SECURITIES)	

O R D E R

On December 9, 1983, Edmonson County Water District ("Edmonson County") filed an application with this Commission requesting authority to adjust its water service rates, to construct a \$1,770,000 waterworks improvement project and to issue certain securities. The rates proposed by Edmonson County would produce annual revenues of \$393,017 which represents an increase of \$48,015, or 14 percent, above actual test-period revenues. Based upon the determination herein, Edmonson County will be allowed the full \$48,015 proposed increase.

On April 4, 1984, a hearing was held in this matter at the Commission's offices in Frankfort, Kentucky. By an Interim Order dated April 17, 1984, the Commission granted Edmonson County a certificate of public convenience and necessity to proceed with the waterworks improvements project and approved the \$1,298,000

amount of financing for the project. This Order will address Edmonson County's application for authority to adjust its rates pursuant to 807 KAR 5:001. There were no intervenors in this matter. All information requested by the Commission in association with this case has been filed.

COMMENTARY

Edmonson County is a non-profit water district organized and existing under the laws of the Commonwealth of Kentucky, and serves approximately 1,797 residential, 93 commercial, and 1 wholesale customer in Edmonson County, Kentucky.

TEST PERIOD

Edmonson County proposed, and the Commission has accepted, the 12-month period ended December 31, 1983, as the test period for determining the reasonableness of the proposed rates. In utilizing the historic test period, the Commission has given full consideration to known and measurable changes found reasonable.

REVENUES AND EXPENSES

This case was predicated upon new construction and additional customers, as well as an existing earnings deficiency. Normally, the Commission will not consider investment, interest or operating expenses outside of the test year, because it violates the test-year concept. One exception to this rule, of necessity, has been in the case of very small utilities with large construction programs, where the use of the test-year concept would yield totally inadequate revenues. In those cases, the Commission has applied a concept much like that used in initial

rate cases where there is no test year experience to base the case on.

The applicant apparently was attempting to justify the increased rates on this basis; however, the testimony presented was based on totally unacceptable methods. Projected operating expenses were based on an average cost per 1,000 gallons of water, a concept that totally disregards the realities of what additional expenses would actually be incurred to produce the additional water, and a 10 percent inflation adjustment to expenses, a concept that this Commission has long rejected as not being known and measurable. No projections of what actual costs would be related to these additional customers, or apparently of the revenue that would be realized from these additional customers was presented. However, it does not appear that the additional project is large enough in relationship to the total district to justify the exception to the test-year concept. In light of this fact, there is no reason to consider this additional investment. However, the Commission has concluded that the following modifications to Edmonson County's actual test-period operations will be necessary to determine a reasonable and acceptable level of revenues and expenses for rate-making purposes:

Utilities Expenses

During the test period Edmonson County incurred expenses for electricity in the total amount of \$43,991, reflecting the costs associated with the electricity used for its water treatment and distribution, as well as the electricity used at its office. The Commission, in its examination of this expense area, has

applied to Edmonson County's test-period electricity consumption data the rates currently being charged by Edmonson County's electricity supplier, Warren Rural Electric Cooperative Corporation, which results in a total allowable expense of \$44,846. To reflect this amount, the Commission has increased Edmonson County's test-period operating expenses by \$855.

Maintenance of Water Treatment Plant

Edmonson County reported operating expenses in the amount of \$26,112 as having been incurred during the test period in association with the maintenance of its water treatment plant. An examination of the breakdown of Account No. 635--Maintenance of Water Treatment Plant submitted by Edmonson County¹ revealed several items that were incorrectly expensed on Edmonson County's test-period statement of income. During the hearing of April 4, 1984, Mr. Nelson Sanders, manager of Edmonson County, stated that there were items included in the breakdown that could possibly be capitalized in utility plant in service, but that such determinations were made by Edmonson County's auditor.² As a result of an examination of the invoices submitted by Edmonson County in association with these expenses,³ the Commission is of

¹ Response to Commission's Information Request dated March 2, 1984, Item No. 8.

² Transcript of Evidence ("T.E."), April 4, 1984, pages 74-75.

³ Response to information requested at hearing of April 4, 1984, Item No. 8.

the opinion that of the \$26,112 reported test-period expenses, a total amount of \$19,965 represents items that should be capitalized in Edmonson County's water utility plant in service accounts. Therefore, the Commission has reduced Edmonson County's test-period operating expenses by \$19,965 to reflect the allowable amount of maintenance expense. The Commission has also increased Edmonson County's test-period depreciation expense by \$2,059 to reflect the amount of depreciation expense associated with the capitalized items.⁴ In addition, the Commission finds that for all future financial-reporting and rate-making purposes, Edmonson County shall capitalize all items of plant in the appropriate utility plant in service accounts in accordance with the Uniform System of Accounts for Class A and B Water Utilities.

Wages and Salaries

According to its statement of income and expenses, Edmonson County incurred wage and salary expenses in the total amount of \$82,864. With regard to this amount, the breakdown of employees' wages and salaries submitted by Edmonson County indicated that

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	<u>Original Cost</u>	<u>Estimated Life</u>	<u>Depreciation Expense</u>
Power Saw	\$ 616	5 years	\$ 123
Pump Installation	6,725	10 years	673
Pump Motor	416	10 years	42
Telemetering Equipment	<u>12,208</u>	10 years	<u>1,221</u>
Total Capitalized Items	<u>\$19,965</u>		<u>\$ 2,059</u>

several of Edmonson County's employees were granted wage increases during the test period. Mr. Max W. Vincent, Chairman of Edmonson County, stated during the hearing of April 4, 1984, that the increase in salary from \$13,500 to \$18,500 granted to Edmonson County's manager was determined on the basis of a comparison of the salaries paid to the managers of various other area water utilities.⁵ It was also indicated that the increase in salary from \$11,107 to \$14,000 granted to Edmonson County's assistant manager was the result of a job promotion which involved additional duties and responsibilities.⁶ In addition, an examination of the breakdown of employees' wages and salaries indicated that Edmonson County's hourly employees received wage increases ranging from 2 to 20 percent.

In determining an acceptable level of salaries and wages for rate-making purposes, the Commission considers the increases granted to Edmonson County's manager, assistant manager, and hourly employees to be reasonable amounts, based upon the duties and responsibilities associated with these positions, as well as the level of salaries paid by comparable utilities to similar employees. To reflect these wage increases on an annual basis, the Commission has increased Edmonson County's test-period operating expenses by \$6,951 thereby resulting in an allowable test-period wage and salary expense of \$89,635.

⁵ T.E., April 4, 1984, page 61.

⁶ Ibid., page 62.

Employee Pensions and Benefits

The breakdown of employee benefits submitted by Edmonson County revealed that Christmas bonuses in the total amount of \$1,250 were paid to employees during the test period. With regard to this fringe benefit, the Commission is of the opinion that, considering the level of wage increases granted during the test period, such bonuses should not be allowed for rate-making purposes. Therefore, the Commission has reduced Edmonson County's test-period operating expenses by \$1,250 to reflect the \$11,659 allowable amount of employee pensions and benefits.

Depreciation Expense

During the test period, Edmonson County reported depreciation expense of \$119,235. Based upon the original cost values and the estimated lives of utility plant reflected per the schedule of depreciation submitted by Edmonson County,⁷ as well as the \$2,509 amount of depreciation associated with capitalized items as determined herein, the Commission has calculated Edmonson County's test-year end depreciation expense to be \$120,341.⁸ This amount, expressed as a percentage of Edmonson County's adjusted test-year end balance of utility plant in service results in

⁷ Response to information requested at hearing of April 4, 1984, Item No. 5.

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Depreciation from schedule	\$118,282
Depreciation on capitalized items	<u>2,059</u>
Adjusted depreciation expense	<u>\$120,341</u>

a composite depreciation rate of 2.26 percent.⁹ In accordance with the Commission's established policy of the disallowance of depreciation associated with contributed property, this composite rate was applied to Edmonson County's adjusted balance of water utility plant in service net of contributions in aid of construction, which resulted in an allowable depreciation expense amount of \$49,902.¹⁰ To reflect this amount the Commission has decreased Edmonson County's actual test-period depreciation by \$69,333.

Taxes Other than Income or Sales

During the test-period, Edmonson County reported taxes in the total amount of \$7,370. Of this total, an amount of \$7,030 represented payroll taxes. The Commission, in determining the allowable test-period amount of taxes, has calculated the ratio of

9	Test-year end utility plant Items to be capitalized Adjusted test-year end utility plant	\$ 5,307,168 19,965 <u>\$ 5,327,133</u>
	Adjusted depreciation Adjusted utility plant in service Composite depreciation rate	\$ 120,341 + 5,327,133 <u>2.26%</u>
10	Adjusted utility plant in service Less: Contributions in aid of construction Net utility plant in service Composite depreciation rate Allowable depreciation expense Actual test-year depreciation expense	\$ 5,327,133 3,119,074 <u>\$ 2,208,059</u> X 2.26% \$ 49,902 <u>119,235</u>
	Adjustment to actual	<u>\$ <69,333></u>

actual test-period payroll taxes to actual wages and salaries to be 8.5 percent.¹¹ This ratio was applied to the \$89,635 allowable amount of test-period wages and salaries as determined herein, resulting in an adjusted test-period payroll tax expense of \$7,619. Therefore, to reflect this allowable amount, the Commission has increased Edmonson County's test-period operating expenses by \$589.

Interest Income

Edmonson County proposed an adjustment to reduce its test period income by \$10,021 to reflect an anticipated zero level of interest income. According to the testimony of Mr. Ralph Anderson, engineer for Edmonson County, this adjustment was made on the assumption that the invested funds on which the interest was being earned would be utilized in the construction of the waterworks improvements project; therefore, no interest income was foreseen as being earned in the future.¹²

As the entire amount of proposed financing for the waterworks improvements project was found to be reasonable and adequate, and as such financing was approved by an Interim Order dated April 7, 1984, the Commission finds the basis upon which Edmonson County has reduced its interest income to be without merit. Based upon the level of investments held by Edmonson

¹¹ Actual test-period payroll taxes
Actual test-period wage and salaries
Percentage

\$ 7,030
+ 82,684
<u>8.5%</u>

¹² T.E., April 4, 1984, pp. 45-46.

County at the end of the test period, as well as the rates of interest being earned on those investments,¹³ the Commission has determined Edmonson County's pro forma test period interest income to be \$11,308. Therefore, Edmonson County's test-period interest income has been increased by \$1,287 to reflect the pro forma amount.

Interest on Long Term Debt

Edmonson County proposed an adjustment to increase its test period interest on long-term debt by \$37,500 to reflect the amount of interest on the \$1,298,000 Farmer's Home Administration loan associated with the waterworks improvements project. As indicated previously in this Order, the Commission is of the opinion that the proposed adjustments relative to Edmonson County's new construction should not be included for rate-making purposes in this case; therefore, the proposed amount has not been allowed as an adjustment to Edmonson County's test-period statement of income and expenses. The Commission has calculated the allowable amount of interest expense on the basis of Edmonson County's test-year end balance of outstanding debt and the applicable interest rates.¹⁴ This computation results in a pro forma interest expense of \$110,035, thereby reflecting an increase of \$653 above actual test-period interest on long term debt.

¹³ Response to information requested at hearing of April 4, 1984, Item No. 7.

¹⁴ Ibid., Item No. 12.

After consideration of the aforementioned adjustments, the Commission finds Edmonson County's test-period operations to be as follows:

	<u>Actual Test Period</u>	<u>Pro Forma Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$350,444	\$ -0-	\$350,444
Operating Expenses	345,268	<82,153>	263,115
Net Operating Income	\$ 5,176	\$ 82,153	\$ 87,329
Interest Income	10,021	1,287	11,308
Interest on Long-Term Debt	\$109,382	653	110,035
Net Income	<u>\$<94,185></u>	<u>\$ 82,787</u>	<u>\$<11,398></u>

REVENUE REQUIREMENTS

The Commission, having concluded that Edmonson County's adjusted test-period operating loss is unjust and unreasonable, is of the opinion that the proposed rates should be approved, as the revenues in the amount of \$393,017 generated thereby will improve Edmonson County's financial position. This revenue, combined with other operating revenues of \$5,442 and interest income of \$11,308 will be sufficient to meet Edmonson County's operating expenses found reasonable for rate-making purposes, service its debt and provide a reasonable surplus.

OTHER ISSUES

Management of Investments

During the test period Edmonson County reported special funds in the total amount of \$97,210 as being composed of a bond reduction fund and a depreciation reserve fund. In addition, at the end of the test period Edmonson County reported a balance of cash and working funds in the amount of \$100,086, and a balance of temporary cash investments of \$87,138. During the hearing of

April 4, 1984, the issue was addressed concerning the level of interest being earned on these funds, which resulted in much confusion regarding the manner in which these funds were invested. Subsequent to the hearing, Edmonson County submitted a schedule reflecting the balance and the method of investment of each fund. This information revealed that Edmonson County had funds invested in non-interest bearing checking accounts, as well as passbook savings accounts and certificates of deposit with interest rates ranging from 5.25 percent to 11.75 percent per annum.¹⁵

Considering the many options that are available to Edmonson County with regard to the investment of these funds, the Commission is seriously concerned about the level of interest income that is currently being realized. For instance, the information submitted by Edmonson County revealed that its depreciation reserve fund, which had a balance of \$72,729 at the end of the test period, was being maintained in a non-interest bearing checking account, whereas Edmonson County's highest yielding savings certificate bearing an interest rate of 11.75 percent reflected an investment of only \$1,000. The Commission is aware that, due to the covenants of its bond ordinances, Edmonson County may be restricted in its utilization of these funds. However, the Commission considers Edmonson County's current investment of these funds to reflect inefficient management of cash assets and urges Edmonson County to reevaluate its position

¹⁵ Ibid., Item No. 7.

with regard to these investments in an effort to achieve better yields from its available resources.

Other Charges

Edmonson County proposed to increase its membership fee from \$10 to \$25, and its reconnect fee from \$10 to \$20. Edmonson County also proposed to establish a service run fee based on mileage in the amount of \$10 for 0-10 miles, \$15 for 10-20 miles and \$20 for over 20 miles. Edmonson County also proposed to increase its tap-on fee for a 5/8-inch X 3/4-inch connection from \$300 to \$325. This required cost justification was provided for all proposed charges and the Commission will allow them to be charged for services rendered.

SUMMARY

The Commission, after considering the evidence of record is of the opinion and finds that:

1. The rates proposed by Edmonson County and contained in Appendix A are the fair, just and reasonable rates to be charged by Edmonson County as they will produce gross annual revenues in the amount of \$393,017.

2. Edmonson County has incorrectly reported as expenses on its test period income statement amounts that should be capitalized as utility plant in service.

3. Edmonson County proposed to increase certain special charges and provided appropriate cost justification for the proposed increases. The Commission is of the opinion that the proposed special charges should be approved.

IT IS THEREFORE ORDERED that the rates proposed by Edmonson County and contained in Appendix A be and they hereby are approved for services rendered by Edmonson County on and after the date of this Order.


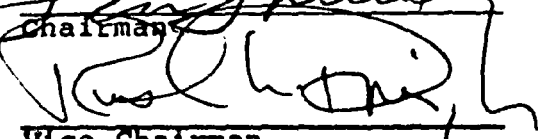

IT IS FURTHER ORDERED that Edmonson County shall capitalize all items of water utility plant in the appropriate plant in service accounts in accordance with the Uniform System of Accounts for Class A and B Water Utilities.

IT IS FURTHER ORDERED that the special charges proposed by Edmonson County and contained in Appendix A be and they hereby are approved for service rendered by Edmonson County on and after the date of this Order.

IT IS FURTHER ORDERED that within 30 days of the date of this Order, Edmonson County shall file its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 22nd day of June, 1984.

PUBLIC SERVICE COMMISSION


Chairman

Vice Chairman

Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION IN CASE NO. 8950 DATED 6/22/84

The following rates and charges are prescribed for the customers in the area served by Edmonson County Water District. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

RATES: Monthly

First	2,000 gallons	\$8.75 Minimum Bill
Next	3,000 gallons	3.45 per 1,000 gallons
Next	5,000 gallons	2.30 per 1,000 gallons
Next	15,000 gallons	1.70 per 1,000 gallons
Over	25,000 gallons	1.15 per 1,000 gallons
City of Brownsville		.92 per 1,000 gallons

Tap-on Fees

Meter Size

5/8-Inch X 3/4-Inch	\$325.00
1-Inch	400.00

For all meters larger
than 1-Inch

Actual cost of
materials and
installation

Membership Fee

\$ 25.00

Re-Connect Fee

20.00

Service Run Fee (or special request)

Distance (1-way) from
District Office to Customer

0-10 miles
10-20 miles
Over 20 miles

\$ 10.00
15.00
20.00